



## **Feedback Statement on the FRC's Proposed Updates to the Strategic Framework and Draft Plan 2009/10**

### **Introduction**

This report summarises the responses to our consultation document "Draft Plan 2009/10, Proposed Updates to the Strategic Framework and 2009/10 Levy Proposals" which we published in December 2008, and provides our feedback on:

- the updates we proposed to our Strategic Framework
- our draft Plan 2009/10.

We received fourteen responses to the consultation document in total. Of these, twelve commented on the proposed updates to Strategic Framework and the draft Plan 2009/10:

- Two business organisations:
  - CBI
  - Quoted Companies Alliance.
- Two investor and other representative organisations:
  - Association of British Insurers
  - FRC Actuarial Stakeholders Interests Working Group.
- Three professional bodies:
  - Actuarial Profession
  - Association of Consulting Actuaries
  - Consultative Committee of Accountancy Bodies.
- Five responses from individual firms:
  - Deloitte LLP
  - Ernst & Young LLP
  - Grant Thornton UK LLP
  - KPMG LLP
  - PricewaterhouseCoopers LLP.

In addition, we received two responses which focused on our Levy Proposals 2009/10:

- Friends Provident
- Royal Mail.

We will publish a separate Feedback Statement on our 2009/10 Levies in May 2009 once we have published our Annual Report and have the necessary data to enable us to confirm the final levy rates.

The updated Regulatory Strategy and finalised Plan 2009/10 are published on our website, together with the responses to the consultation document, at [www.frc.org.uk/about](http://www.frc.org.uk/about).



## Feedback on our proposed updates to our Strategic Framework

Our Strategic Framework, which we developed in consultation with our stakeholders, sets out our overall Aim – confidence in corporate reporting and governance – and the outcomes which, in our view, contribute to the achievement of that aim.

This section summarises the response, and our feedback, in relation to certain updates which we proposed in order to enhance the usefulness of the Framework without changing its underlying purpose or scope. We will publish an updated Strategic Framework (version four) as part of a revised Regulatory Strategy. The updated Framework will:

- include “audit-related services” in Strategic Outcome Three (Auditing) rather than Outcome Five (Professionalism of accountants and actuaries) as in the previous version (version three) of the Regulatory Strategy
- differentiate between outcomes related to legislation and to regulatory requirements in Strategic Outcomes One to Five in order to clarify those areas for which the FRC is directly responsible and those where the Government or EU have primary responsibility and we have an influencing role
- update Outcome Six (FRC effectiveness) to ensure that it fully reflects developments in the Better Regulation agenda.

### *Responses*

Four respondents indicated general support for all the proposed updates.

Other respondents commented on specific aspects of our proposed updates as follows:

#### *Including “audit-related services” within the scope of Outcome Three (Auditing)*

One respondent supported this proposal. Two respondents suggested that the FRC would need to consider in more detail the definition of related services. One respondent expressed reservations about the proposal on the basis that it was not clear whether the FRC was proposing to extend the scope of its responsibilities. One respondent suggested that it would not be appropriate for the FRC to propose any additional regulation in this area.

#### *Differentiating between legislative and regulatory outcomes*

Two respondents supported this change.

#### *Updating Outcome Six (FRC Effectiveness)*

Two respondents supported this change.

#### *Other aspects of the FRC’s Regulatory Strategy*

One respondent commented on the importance of defining appropriate outputs to correspond to the outcomes defined in the Framework.



One respondent suggested more explicit recognition of the role of the accountancy professional bodies in the Regulatory Strategy.

### *FRC feedback*

We believe that our stakeholders are generally supportive of the proposed updates to the Strategic Framework. We have, therefore, incorporated these updates in the revised version of our Regulatory Strategy and have structured our Plan 2009/10 on the updated Strategic Framework. We will continue to keep the Framework under review to ensure that it remains appropriate.

We have noted the comments about the inclusion of audit-related services within the scope of Outcome Three of the Strategic Framework rather than Outcome Five. Audit-related services may include a wide range of services including preparing investment circulars and compilation reports. It is, therefore, difficult to define these services precisely. We believe it is appropriate to use the general description that was included in the draft updated Strategic Framework. We will consult appropriately on any future activities or projects in relation to audit-related services in the context of our annual work programme.

The Strategic Framework identifies the outcomes which contribute towards confidence in corporate reporting and governance. It reflects medium term aspirations. As part of our planning process, we identify the outputs which will be achieved by completing our annual work programme. It would not be appropriate to include these outputs in the Framework itself but the work programme is structured around the Strategic Framework.

The Strategic Framework includes outcomes for which market participants and other organisations are primarily responsible as well as those for which the FRC is primarily responsible. In identifying the outputs in the annual work programme, we focus on those which relate to activities or projects which we carry out ourselves – though a number of these activities and projects are aimed at monitoring or influencing market participants or other organisations.

We have included references to the Consultative Committee of the Accountancy Bodies (CCAB) and the member bodies of the CCAB in the section of the updated Regulatory Strategy setting out the powers of the FRC and our Operating Bodies.

## **Feedback on our draft Plan 2009/10**

The following section summarises the response, and our feedback, in relation to our overall Aim and the six Strategic Outcomes defined in our Strategic Framework, specifically:

- our assessment of the major risks
- the scope and relevance of our major activities and projects in 2009/10
- other major risks which may emerge beyond the 2009/10 horizon
- our budget and funding requirements for 2009/10.



This section does not summarise all of the detailed comments on the FRC work programme. We will, however, have regard to those comments in implementing the activities and projects included in the work programme; and will involve respondents, as appropriate, where they have indicated their willingness to contribute to specific activities or projects.

We have, in general, given greater weight to those issues which have been the subject of comments from a number of respondents. But we have, where we believe it to be appropriate, included some issues which have been the subject of comment from a single respondent.

## **Overall Aim – Confidence in corporate reporting and governance**

### *Our assessment of the major risks in relation to confidence in corporate reporting and governance*

No respondent disagreed with our assessment that there are currently a number of significant risks to aspects of confidence in corporate reporting and governance which would, if they materialise, threaten the achievement of our overall Aim, although one respondent commented that the current tougher economic conditions could heighten awareness of the need for high quality financial reporting.

In general, respondents supported our assessment of the major risks.

### *The scope and relevance of our major activities and projects and work programme*

In general, respondents supported the overall direction of our Plan and work programme (subject to the comments set out in this Statement in relation to the individual Strategic Outcomes), but there was also a strong message that it would be important for the FRC both to focus our activities on the major known risks and to remain alert to emerging risks, particularly in the current environment.

### *Other major risks which may emerge beyond the 2009/10 horizon*

Respondents noted that other risks may well emerge in relation to the tougher economic conditions.

### *FRC feedback*

As a result of the comments we have received, and our own further consideration of the risks to confidence in a number of aspects of reporting and governance, we believe that we have been able to further focus our Plan for 2009/10 on the major issues of concern in relation to the tougher economic conditions.

We recognise that we will need to be alert to, and respond appropriately to, the further risks that may emerge and to consider particular aspects of those risks which have already been identified, for example in relation to the heightened risk associated with fraud.



Maintaining justified confidence in corporate reporting and governance in the UK depends primarily on the role of boards, preparers, auditors, accountants and actuaries in applying high standards of reporting and governance diligently and intelligently in difficult circumstances. We have, therefore, included an additional section in the Plan to emphasise these risks, and our response.

## **Outcome One – Corporate governance**

### *Our assessment of the major risks in relation to confidence in corporate governance*

No respondents disagreed with our assessment that there are at present significant risks in relation to confidence in corporate governance.

Two respondents identified an additional risk: that in the current economic environment the UK's "comply or explain" approach may suffer a degree of loss of credibility.

### *The scope and relevance of our major activities and projects and work programme*

Two respondents called for a review of the Combined Code to ensure that it remains credible. Another respondent suggested that the FRC should both proactively address any perceived shortcomings in the "comply or explain" approach and seek to influence international corporate governance developments.

### *Other major risks which may emerge beyond the 2009/10 horizon*

One respondent noted that the increased Government involvement with the governance of the banking sector may have implications for the future development of the regulatory framework for corporate governance.

### *FRC feedback*

We acknowledge the significant concerns in relation to confidence in corporate governance and the importance of maintaining a proportionate and effective UK regulatory regime for corporate governance.

In March 2009, we announced that we would review the effectiveness of the Combined Code and have included this as a major project in the Plan 2009/10.



## Outcome Two – Corporate reporting

### *Our assessment of the major risks in relation to confidence in corporate reporting*

No respondents disagreed with our assessment that there are at present significant risks in relation to confidence in corporate reporting. One respondent emphasised the general risks to corporate reporting arising from tougher economic conditions.

One respondent emphasised the risks to the development of principles-based standards caused by pressure to achieve convergence between IFRS and US GAAP.

### *The scope and relevance of our major activities and projects and work programme*

Two respondents emphasised the importance of the FRC's role in influencing the development of principles-based IFRS. One of these respondents proposed that the FRC should expand its review of market comment in relation to fair value to cover other areas of IFRS, including accounting for impairment, disclosure of post-retirement benefits and the guidance on post balance sheet events in difficult circumstances. One respondent emphasised the importance of progress on the ASB's project to provide a clear strategy on the future of UK GAAP and its convergence with IFRS.

One respondent emphasised the importance of the FRC's role in influencing the development and co-ordination at EU and global level of activities designed to promote compliance with reporting requirements.

Two respondents emphasised the importance of the FRC's on-going project to consider the complexity of corporate reporting.

One respondent emphasised the importance of narrative reporting.

One respondent suggested that the FRC should consider the issue of disclosures in relation to carbon emissions and risks related to climate change.

### *Other major risks which may emerge beyond the 2009/10 horizon*

One respondent noted that further pressures on corporate reporting are likely to surface in the medium term.

### *FRC feedback*

The message we have drawn from the comments we have received in relation to corporate reporting are that we will need to continue to devote significant effort to influencing international initiatives (including those relating to compliance) and to supporting international standards which are independently set and principles-based.



We will consider the observations which respondents have made when completing the activities described in the plan; in particular, influencing the development of IFRS and continued support in the EU for maintaining the IASB and other standard setters' ability to exercise independent judgement in setting accounting standards.

We included a major project in the draft Plan to take forward our consideration of the complexity of corporate reporting. This is included in the finalised Plan.

We included in the draft Plan a major project to review narrative reporting in the light of the business review requirements of the Companies Act 2006 and review the need for additional disclosure requirements relating to business models. This is included in the finalised Plan.

We included in the draft work programme a project to monitor developments in sustainability reporting. This is included in the finalised work programme. We will consider the appropriate FRC response to these developments.

### **Outcome Three – Auditing and related services**

#### ***Our assessment of the major risks in relation to confidence in auditing and related services***

One respondent commented that the UK's current arrangements in relation to auditor liability increase the risk that a major audit firm may leave the market.

One respondent drew attention to the risks associated with the co-existence of IFAC and APB ethical standards and the registration of third country auditors.

#### ***The scope and relevance of our major activities and projects and work programme***

Two respondents asked the FRC to take an active role promoting auditor liability agreements.

One respondent emphasised that it would be important for the FRC to influence any future developments, at both UK and international level, in relation to the regulation of auditing. One respondent highlighted the importance of the implementation in the UK of new ISAs resulting from the IAASB Clarity project. One respondent emphasised that the FRC should also seek to influence any developments (including in the IAASB) in relation to audit-related services.

One respondent commented on the continuing importance of the FRC's role in monitoring and, where appropriate, implementing the recommendations of the Market Participants' Group relating to competition and choice in the audit market.

Four respondents noted that the FRC should consider what activity it should undertake in relation to audit-related services.



### *Other major risks which may emerge beyond the 2009/10 horizon*

One respondent noted certain specific risks that may emerge beyond 2009/10, including a growing emergence of fraud and a widening expectations gap between auditors and investors.

### *FRC feedback*

We have identified in the Plan the risks associated with the current high degree of concentration in the UK audit market as a major risk which is likely to continue into the medium term.

We recognise the significance of the issues associated with auditor liability agreements and have included a project in the work programme to monitor developments; but the most significant issues at present in relation to the use of such agreements are a matter primarily for the Government.

We are alert to the impact of tougher economic conditions on the work of auditors and the need to ensure that the regulatory framework for auditing remains appropriate and is effectively applied. We will continue actively to engage in the work of the IAASB.

We note the comments about ethical standards and third country auditors. We do not agree that it would be appropriate to replace the APBs's ethical standards with the IFAC Code at this time. We believe that there are a number of important areas in which the APB standards are more robust than the IFAC Code.

We included a major project in the draft Plan in relation to the implementation of the Statutory Audit Directive, which is included in the finalised Plan, and have highlighted the risks associated with the ending of the transitional arrangements for foreign auditors.

We will, during 2009/10, consider the scope of our activities in relation to audit-related services. We have included a project in the work programme to review the extent to which the practice assurance schemes operated by the accountancy professional bodies provide an appropriate degree of confidence in services provided by their members in practice.

## **Outcome Four – Actuarial practice**

### *Our assessment of the major risks in relation to actuarial practice*

Two respondents supported our assessment that the most significant risk in relation to confidence in actuarial practice arises from the uncertainties associated with current tougher economic conditions. No respondent disagreed with this assessment.





*The scope and relevance of our major activities and projects and work programme*

Three respondents emphasised the importance of progress in implementing new technical actuarial standards which will be of practical relevance in addressing the major risk we have identified.

*Other major risks which may emerge beyond the 2009/10 horizon*

No additional major risks were identified.

*FRC feedback*

The FRC is making significant progress in developing a new suite of technical actuarial standards, and will have regard to the comments about the urgency of this work.

**Outcome Five – Professionalism of accountants and actuaries**

*Our assessment of the major risks in relation to confidence in the professionalism of accountants and actuaries*

Two respondents drew attention to the increased risk of serious fraud in the present tougher economic climate.

One respondent noted the continuing risks associated with the recruitment and retention of high quality individuals by the auditing profession.

One respondent commented that the risks associated with the delays in developing a principles-based ethical code for actuaries are mitigated by the existing professional conduct requirements maintained by the Actuarial Profession.

*The scope and relevance of our major activities and projects and work programme*

One respondent expressed support for the proposed project to review the regulatory framework for professional discipline and the enforcement of standards, including the role of the FRC within the framework.

*Other major risks which may emerge beyond the 2009/10 horizon*

No additional risks which might emerge over the medium term were identified.



### *FRC feedback*

We have noted carefully the comments in relation to this outcome. We value the strong support of the accountancy and actuarial professional bodies for the work of the FRC and will take these comments into account in implementing our Plan and work programme in 2009/10.

We have included as a major risk in the finalised Plan that current economic conditions may increase the pressures on accountants and actuaries to make or accept inappropriately aggressive judgements and take or support inappropriate decisions.

The project to review the effectiveness of the regulatory framework for professional discipline and enforcement of standards, including the FRC's role within the framework is included in the finalised Plan.

## **Outcome Six – FRC Effectiveness**

### *Our assessment of the major risks in relation to confidence in the effectiveness of the FRC*

Two respondents commented on the potential merit of drawing a more explicit distinction between shorter term risks, particularly those associated with current tougher economic conditions, and longer term risks.

### *The scope and relevance of our major activities and projects and work programme*

Two respondents commented that it would be helpful for the FRC to put greater emphasis on impact assessment and continue its consideration of the cost-effectiveness of its regulatory activities.

One respondent commented on the importance of effective co-ordination between the FRC's Operating Bodies. One respondent commented on the need to ensure that the Operating Bodies' priorities appropriately reflect the FRC's Plan.

### *Other major risks which may emerge beyond the 2009/10 horizon*

One respondent noted the risk that the FRC and other regulators may focus too much on immediate aspects of current conditions and lose focus on the longer term and emerging risks.

### *FRC feedback*

We have noted the comments on our own effectiveness and will consider how we can address them in our work in 2009/10 and future years.



We will continue to consult on our assessment of the major risks to confidence in corporate reporting and governance and our response to those risks in terms of the activities and projects we include in our annual plans.

In implementing our activities and projects we will continue to ensure that the Operating Bodies' priorities appropriately reflect the FRC's Plan and that there continues to be effective co-operation between the Operating Bodies to address cross-cutting issues.

We are committed to the Government's principles of good regulation and to following good practice in implementing the principles. We consulted stakeholders on the cost-effectiveness of FRC regulation in 2008/09. We will continue to consider ways to enhance the cost-effectiveness of, and assess the impact of, FRC regulation and repeat the consultation exercise, probably in 2010/11.

## **Funding and expenditure proposals for 2009/10**

### *Responses*

Three respondents supported the proposed increases in the FRC's budget. One of those respondents commented that the FRC's budget, relative to the scale of our operations, is appropriate. However, five respondents called for more explicit justification of the proposed increase in the budget.

Three respondents supported the proposed increase in the level of our reserves.

### *FRC feedback*

We fully acknowledge and support the principle that the FRC should exercise tight budgetary control and fully justify any increases in our budget, particularly in the current climate.

We have reviewed our budgetary requirement for 2009/10 and have revised our assessment, based on the latest information available to us. In regard to accounting, auditing and corporate governance, we have reviewed our requirements and have reduced budgeted core operating costs by £0.2m to £12.5m.

In regard to actuarial standards and regulation, we have reduced our overall funding requirement by £0.1m to £2.6m because we believe that the level of general reserves is now adequate.

**FRC**

**April 2009**